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[XX] Via Hand Delivery

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PUBLIC UTILITIES COMMISSION

The Honorable Chairman and Members of the
Hawaii Public Utilities Commission
Kekuanaoa Building
465 South King Street, Room 103
Honolulu, Hawaii 96813
Attn: Ji Sook Kim, Esq.

Re: Docket No. 2009-0049 - Wai'ola O Molokai, Inc.

Dear Chairman, Commissioners, and Commission Staff:

Pursuant to the Stipulated Regulatory Schedule attached to the Order Approving Proposed Procedural Order, as modified, filed November 6, 2009, the County of Maui submits its Statement of Probable Entitlement concerning the Amended Application for a rate increase filed by Wai'ola O Molokai, Inc. ("WOM") on June 29, 2009.

I. INTRODUCTION

The County respectfully submits that WOM is not entitled to the rate increase requested. WOM's losses and its purported inability to operate under prior or existing rates is a direct result of WOM's parent company's decision to withdraw its commercial operations from West Molokai. WOM is a subsidiary of Molokai Properties, Ltd. ("MPL"). During the 1970's, MPL embarked on an ambitious plan to develop West Molokai. There is no doubt that the water utility that is the subject of this rate making proceeding was designed and built to benefit MPL's commercial real estate development plans. Now that MPL has ceased operating, the remaining rate payers (i.e., the County and residents of West Molokai) should not be forced to make up the difference and pay for a

utility service that was built to benefit MPL and its commercial operations.

II. BACKGROUND

On June 29, 2009, WOM filed an Amended Application requesting, among other things, a revenue increase of over 380%. On September 11, 2009, the County of Maui timely filed a motion to intervene, which the Commission granted on October 16, 2009.[1] On November 6, 2009, the Commission entered an Order Approving Proposed Procedural Order, as Modified, which attached as Exhibit "A" a Stipulated Regulatory Schedule.

According to the Stipulated Regulatory Schedule, the parties must file simultaneous Statements of Probable Entitlement on March 11, 2010 "if no Settlement Pre Hearing Conference." Also according to the Regulatory Schedule and pursuant to HRS § 269-16(d), the Commission is required to issue an Interim Decision and Order concerning the rate relief requested by April 29, 2010, unless the Commission deems the evidentiary hearings incomplete, in which case the commission may postpone its interim rate decision for thirty days to May 29, 2010. By letter dated March 8, 2010, the Commission notified the parties that the pre-hearing conference is scheduled for April 27, 2010 at 11:00 a.m. and the evidentiary hearing is scheduled for May 19 through May 21, 2010.

III. DISCUSSION

A. General Principles Regarding Rate Making.

Section 269-16 of the *Hawaii Revised Statutes* authorizes the Commission to establish utility rates that are "just and reasonable." The governing principle underlying a "just and reasonable" rate is the right of the public on the one hand to be served at a reasonable charge, and the right of the utility to a fair return on the value of its property used in the service.

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[1] *See* Order Granting the Motions to Intervene Filed by the County of Maui and Stand for Water, filed October 16, 2009.

A return is deemed "fair" or "reasonable" if it produces a fair rate of return on the rate base. *In re Hawaii Electric Light Co., Inc.*, 60 Haw. 625, 632, 594 P.2d 612, 628 (1979). The determination of a proper rate base entails a valuation of the property of the utility devoted to public utility purposes on which the utility is allowed to earn an appropriate rate of return. *In re Puhi Sewer & Water Co., Inc.*, 83 Haw. 132, 137, 925 P.2d 302, 307 (1996); *see also, Honolulu Gas. Co. v. Public Utilities Comm'n*, 33 Haw. 487, 493 (1935) (rate base has been defined as "the present value, . . . of the property both tangible and intangible owned by the company used and useful in its utility operations. . .").

The standard for determining a fair rate of return has been characterized by the Hawaii Supreme Court as "deceptively simple" and has been articulated as follows:

> There is no particular rate of compensation which must in all cases be regarded as fair earnings for capital invested in business enterprises. Locality, risks incurred and prevailing local rates on similar investments are all factors to be considered. Fair return is the percentage rate of earnings on the rate base allowed the utility after making provision for operating expenses, depreciation, taxes and other direct operating costs. . . . Fair return is something over and above the usual interest rate on well-secured loans to compensate for the risks and hazards of business and for the profits of management.

Id. at 636, 594 P.2d at 620 (quoting *Honolulu Gas Co. v. Public Utilities Commission*, 33 Haw.487, 518- 519 (1935)). The reasonableness of rates is not determined by a fixed formula, but is a fact question requiring the exercise of sound discretion by the Commission. *Id.*

Generally, regulatory commissions may consider a parent corporation's capital structure in setting an appropriate rate of return for a utility subsidiary. *See e.g., Hawaii Electric Light Co., Inc.*, 60 Haw. 625, 632, 594 P.2d 612, 628 (1979) (observing that when a parent owned all or virtually all the common stock of a subsidiary, the cost of equity to the subsidiary could only be reckoned on the basis of the cost of equity capital to the parent, and that most

utility regulatory commissions had recognized this relationship between a corporate subsidiary and its parent). In other words, a regulatory commission may look through the corporate form of affiliated corporations and probe for economic realities. *See United Gas Pipe Line Co. v. Louisiana Public Service Comm'n*, 241 La. 687, 707, 130 So.2d 652, 660 (1961).

The general principle that the capital structure of a utility's parent corporation can be considered in determining the capital structure of the utility to arrive at an appropriate rate of return for the utility is codified in HRS § 269-16(e) which states:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the State of Hawaii, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the commission may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among the organizations, trades or businesses, if it determines that the distribution, apportionment or allocation is necessary to adequately reflect the income of any such organizations, trades or businesses to carry out the regulatory duties imposed by this section.

It is with these general principles in mind that the County believes WOM is not entitled to the rate increase requested. Further, the County believes that it is well within the Commission's authority to impute the capital structure of WOM's parent company, MPL, to establish a fair and reasonable rate for WOM to charge its utility customers on Molokai.

B. The Rate Payers Should Not Be Forced to Pay for the Utilities' Excess Capacity as a Result of MPL's Withdrawal from Molokai.

MPL owns approximately 70,000 acres of land on the island of Molokai. During the 1970's, MPL and its predecessors sought to develop a large portion of its property located throughout West Molokai. Among the ambitious development plans by MPL that came to fruition were resort properties, a golf course, and various residential communities, as well as commercial properties.

As part of its real estate development plans, MPL designed and built water systems to provide water to its properties, including to resort properties and a golf course. Eventually, MPL created subsidiary utility companies, including WOM and Molokai Public Utilities, Inc. (collectively, "Utilities"), to provide the water to its customers.

In approximately March 2008, MPL abruptly announced that it was ceasing its business operations, including closing Molokai Ranch. By the end of 2008, most, if not all, of MPL's business operations closed. On May 8, 2008, MPL announced that its Utilities could no longer afford to operate on Molokai and unless a third-party or a governmental entity (i.e., the County) took over utility operations, there would be a shut-down in water and sewer service to West Molokai by the end of August 2008.

The Utilities and MPL cannot credibly dispute that the utility systems were designed and built largely to service MPL's ambitious commercial developments, including the resort properties and golf course. The Utilities and MPL also cannot credibly dispute that MPL's commercial operations were the largest consumers of water and, as a result of MPL's closure of its business operations, the Utilities are now left with oversized utilities or what is known as excessive capacity. Thus, the reason why the Utilities cannot afford to operate at prior or existing rates is because of MPL's withdrawal of its business operations on Molokai.

It would be fundamentally unfair to impose substantial rate increases upon the remaining ratepayers following MPL's withdrawal of its commercial operations, especially when the utility systems were built primarily to benefit MPL's commercial developments. The Commission would be well within its authority to adjust the proposed rates to accommodate the excess capacity left by MPL closing its business operations on Molokai.

C. WOM Is Not Entitled to a Rate Increase When Issues Remain as to Excessive Water Loss in MPU's Rate Proceeding.

The rate payers also should not be forced to pay substantially higher rates for water they do not consume. As noted by the Consumer Advocate, WOM does not have a single water source like its sister company, Molokai Public Utilities, Inc. ("MPU"), but instead receives water from MPU, as well as

from the Department of Hawaiian Homelands. Issues arose in MPU's prior rate proceeding (Docket No. 02-0371) concerning water loss or waste from Well 17. In that proceeding, the Commission ordered MPU to "provide quarterly reports" to the Commission and to the Consumer Advocate:

> . . . on the status of the upgrade of its facilities, scheduled to begin July 2003, including information on the progress of the construction of the new transmission facilities, and any other steps implemented by MPUI to reduce the amount of water loss and further upgrade its water system.

Decision and Order No. 20342 in Docket No. 02-0371 at 21.

In its current rate case proceeding,[2] MPU does not dispute that it has not been able to resolve the water loss issues. *See Rebuttal Testimony of Robert L. O Brien* at 18: 1 - 15 filed in Docket No. 2009-0048 ("[MPU] . . . was not able to quantify the water used for treatment or have any data to support the sources of the other water losses").

Given that MPU has unresolved water loss issues and that WOM's water source includes MPU, the Commission should not approve WOM's requested rate increase while water loss issues remain outstanding. WOM (as well as MPU) should be required to answer to the Commission and explain the discrepancies as MPU was ordered to do back in 2003.

D. The Commission Should Consider MPL's Capital Structure and Transactions Between MPL and its Utilities.

Given that there are discrepancies between WOM's accounting records and the consolidated tax returns of the parent company (e.g., allowable depreciation costs), the Utilities are not entitled to the relief requested and an evidentiary hearing is necessary to fully develop the record and to vet these issues and any other issues raised by the County and the Consumer Advocate.

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[2] PUC Docket No. 2009-0048.

IV. CONCLUSION

The County of Maui respectfully submits that WOM is not entitled to the rate increases requested. The Commission should not allow WOM to charge utility customers substantially increased rates when the utilities were built largely to benefit MPL's ambitious development plans and MPL decided to cease operating on Molokai. MPL's withdrawal of its business operations on Molokai is the reason why WOM can no longer afford to operate at its prior rates. The rate payers should not be forced to make up the difference and pay higher rates because of MPL's business decision to abandon its commercial operations on Molokai. Further, because WOM's water sources include MPU, the Commission should not make any decision concerning rates until the water loss issue raised in MPU's prior rate case has been properly and fully addressed by MPU. Finally, the Commission should not render a decision until the discrepancies between WOM's accounting and tax records are fully vetted.

Very truly yours,

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